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**BEFORE THE**
**POSTAL REGULATORY COMMISSION**
**WASHINGTON, DC 20268-0001**

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| Annual Compliance Report, 2015 | ) ) ) | Docket No. ACR2015 |

# INITIAL COMMENTS OF THE AMERICAN CATALOG MAILERS ASSOCIATION

(February 2, 2016)

Pursuant to Commission Order No. 2968 (Dec. 30, 2015), the American Catalog Mailers Association (ACMA) is pleased to submit these comments.

Catalogs are a valued source of goods and services, many of which are otherwise difficult to find. They provide information and serve as resources for things otherwise hard to find. They are a major component of the Standard Mail class, and they are linked to other mail categories. On average, catalogers spend over half of their marketing budgets on postage.[1] The number of customers that can be profitably mailed is directly proportional to the cost to reach those customers. Rates for sending catalogs, then, are critically important to catalogers and catalog recipients.

[1] An ACMA unpublished Survey of Member Mail Use, 2012, showed 54%, a figure members have told us has increased since.

**I.  Mail Usage and Postal Service Costs.**

Predominantly, catalogs are classified as flats.  They are sent via the Commercial categories of High-Density and Saturation Flats and Parcels (HD), Carrier Route (CR), and Standard Flats (SF) and other categories, each of which has been designated as a separate product.  The splits among these products depend on postal regulations and the density (in terms of pieces per route) of specific mailings.  For example, regulations require a minimum of 125 pieces per route to use HD and 10 pieces per route to use CR.  But mailings **are not required** to use HD or CR.  Pieces qualifying for CR **must** be sent SF if they are destined to FSS areas.  Use of 5-digit presort **is required** if there are 10 or more pieces for a 5-digit area.  Similar requirements relate to the usage of ADC presort and 3-digit presort.  That mailers are faced with this perplexing matrix of options and requirements has three implications:  (1) the volumes of specific mailings depend on weighted averages of the rates for the applicable postal products, (2) the various categories are highly interdependent, and (3) the splits among the categories make it difficult to review the rates for catalogs.  This complexity results in a cacophony of rates, rules and regulations that makes managing catalogs difficult for both the mailer and the Postal Service.

Excepting Nonprofit, which Congress designated to have especially low rates, the FY 2015 cost coverages reported for the categories used by catalogs are:

| Table 1<br>Commercial Cost Coverages FY 2015 | |
|---|---|
| Standard Flats + Carrier Route | 108.9% |
| High-Density and Saturation Flats and Parcels | 177.8% |

These coverages are readily calculable from the information provided in USPS LR-27. They reflect 4 months' of the rates implemented May 31, 2015. By product designation and Commercial vs. Preferred, these coverages are:

| Table 2<br>Flats-Category Cost Coverages FY 2015 | | | |
|---|---|---|---|
| | Commercial | Nonprofit | Product Total |
| Standard Flats (SF) | 88.6% | 52.9% | 80.2% |
| Carrier Route (CR) | 134.7% | 88.8% | 131.1% |
| High-Density (HD) | 177.8% | 94.5% | 173.3% |

This year, much more than last, SF contains a substantial portion of otherwise-CR that was **required** to shift to SF. The presort categories above CR have a **choice** whether to shift to FSS, provided they comply with FSS preparation and presentment rules. HD flats pay a rate penalty if they move to FSS, although they are permitted to do so.

Despite the mix of constraints and interdependencies just outlined, concern has been expressed that the cost coverage for SF (shown in the table to be 80.2 percent, Nonprofit included) should be higher. Postal Service Compliance Report at 17 ("Postal Service … agrees with the Commission that having products cover their costs is an appropriate long-term goal" (footnote omitted)). ACMA understands arguments that SF mail (including otherwise-CR mail) **might** be receiving an intra-group subsidy from CR and HD mail, based on the costs as reported, and understands that steps toward this "goal" could involve increasing SF rates and lowering HD and CR rates. Indeed some of our highest-density members might be helped by such a change. Still, ACMA believes that it would be best not to plan significant rate adjustments at this time, especially given the impact on an industry segment still reeling from the significant increases that resulted from Docket No. R2006-1, and **especially** when the system is in the midst of the largest flats automation project ever attempted. Driving further flat volume out of the mailstream is wholly counterproductive at precisely the time flat volume is needed to optimize automation initiatives.

## II. The Situation Does Not Call for Rate Adjustments.

In virtually all regards, the situation surrounding the processing and delivery of flats is in disarray.

1. The FSS requirements have blurred further the distinctions among the various categories. Also, except for very minor recognition before, the FSS discounts were not implemented until May 31, 2015, two-thirds of the way through the fiscal year. This has caused shifting that is still underway. It should be given more time.

2. Flats automation appears to be on a path to lower costs and improved efficiency, much as appears to have occurred for letters over some period. The Postal Service is paying considerable attention to flats, including operating measures, special programs, and plans for a high-speed feeder. And mailers are working with the Postal Service to improve machinability and align preparation with processing. (*See* Postal Service Compliance Report at 18-30.)

3. The workshare passthroughs and associated cost relations appear far from any semblance of equilibrium.

The mail processing cost for 5-digit automation is 17.9 cents higher than for CR. This is too much higher. The FSS rates should not be higher than the CR rates, yet the passthroughs underlying the current discounts are reported as 162.2 percent and 366.7 percent. These are distressingly high. Attention should be directed to why this situation exists

4. ACMA is puzzled that the cost avoidances for the FSS discounts do not appear to include any carrier savings. Savings in carrier costs are a central element in the ROI calculations for the FSS system, and if flats were to return to CR, carrier costs would certainly increase. Non-CR mail should also be shifting to FSS, and carrier savings should exist for it too. ACMA would appreciate the Commission looking into this matter, perhaps having the Postal Service develop more thorough costs for the various FSS and non-FSS categories.

In view of this situation, as noted above, ACMA believes that it would be best not to pursue significant rate adjustments at this time.

## III. SF Rates and Catalog Rates Generally Are Below Stand-Alone Costs, Which Suggests That They that Are Subsidizing Others.

When questions are raised about whether categories of mail are receiving subsidies in their rates, two limits are normally examined. One is that rates should be above incremental costs, though these are difficult to quantify.[2] The other is that rates should be below stand-alone costs. In Docket No. R87-1, William J. Baumol, a regulatory economist of worldwide stature, explained:

> The stand alone cost of a service (which might better have been called its entry-inducing rate level) is defined as the cost (including a competitive return to capital) that would be incurred by an efficient entrant if it were to undertake to provide that service alone, or if it were instead to provide that service in combination with some other services of the enterprise whose regulation is at

[2] *See* Docket No. RM2016-2, Initial Comments of ACMA (January 27, 2016) at 32.

> issue. (The concept then becomes the stand alone cost of the combination of services). The competitive market standard for regulation requires that no price or prices be permitted to yield revenues that exceed the corresponding stand alone costs. Thus, if the price of service A is set at $100, but another firm could supply the same service by itself at $90, then the stand alone condition is violated. A stand alone ceiling on the revenues of a given volume of a service or of a combination of such services offers consumers of services that are not supplied under competitive conditions all of the protection against overpricing that the market mechanism would have given them if the market had in fact been rendered competitive by perfectly costless entry. For in those circumstances prices might very well have been set close to stand alone costs, but they could not have exceeded stand alone cost. …
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> Since stand alone cost is the ceiling that complete competitive freedom of entry imposes upon rates, then the goal of offering customers of the regulated firm all the protection against overpricing that competition would bring them is achieved if the regulator adopts stand alone costs as the ceiling upon rates.

ACMA believes that the rates for Commercial flats in the Standard class, with the possible exception of Saturation, have risen to a level that is at or above the stand-alone constraint, and that, but for the mailbox rule and the limited extent to which catalogs are constrained by the Private Express Statutes, a private delivery service would happily provide service for these pieces.[3]

This question has been raised in the past, particularly in Docket No. R90-1, where it was found difficult to agree on evidence that private delivery was really feasible. Subsequently, evidence was developed through the enterprise of Time Warner, which ran a private delivery operation named Publishers Express from 1989 to 1995. Publishers Express "grew from serving 2 ZIP Codes in one city [Atlanta] to

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[3] Catalogs under 24 pages are constrained by the Private Express Statutes to be delivered by the Postal Service. 39 C.F.R. § 310.1. Many catalogs are over 24 pages. Periodicals are not constrained by the Statutes.

serving 1,000 ZIP Codes in 32 cities."[4] Publishers Express charged 15 percent below corresponding Postal rates and was marginally profitable, depending on the particular arrangement measured. However, but for the constraint of the mailbox rule, Publishers Express would have continued expanding and would be delivering all, or nearly all, magazines in the United States today, along with many other machinable flats.

Our conclusion about the viability of Publishers Express is based on the following:

1. Since 1997, Periodicals rates, which were a principal focus of Publishers Express, have increased 72.9 percent and the rates of Standard Flats have increased 88.6 percent. During the same period the CPI has increased only 49.2 percent. Carrier Route Standard rates have increased as well, but a corresponding figure for them is not available.

2. Were the mailbox rule to have been relaxed, Publishers Express could have charged rates in the neighborhood of 3 percent to 5 percent below corresponding Postal rates, instead of 15 percent below. This would have increased its profits significantly.

3. Publishers Express was a manual operation. If private carriage had been allowed to compete on equal terms, it would, with cooperation from mailers, have lowered costs through the application of mechanization. Opportunities for such gains are greater now than then.

4. Due partly to comailing, more Standard and Periodicals mail is dropshipped now than in the early 1990s. Both of these activities reduce the costs for private delivery.

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[4] Docket No. C2004-1, Response of TW et al. Witness Mitchell to MH/TW et al-T1-10 (June 22, 2004). *See also* Docket No. C2004-1, Tr. 3/1172-1173 and Docket No. PI2008-3, Initial Comments of Time Warner Inc. in Response to Commission Order No. 71, at 4-7 (June 25, 2008).

These considerations suggest a net boost in Publishers Express revenues, before an effect from automation, on the order of 35 percent. And without the mailbox rule, its volume would have grown tremendously, to a level of health and beyond.

Questions have been raised about whether a private delivery operation would provide the same level of service as the Postal Service. We believe it is clear that an entrant could meet Postal-Service service levels for relevant flats with three-day delivery, which would always allow efficient preparation for the next delivery day. And mailers of mail with a higher service standard, who do not need that level of service, would have the option of private delivery too. This leaves only the question of universality. We agree that the current level of service to rural Alaska might not be provided, but not all of its costs are being allocated to it now. In other areas, service would be provided.

ACMA has raised important questions about the costs that are apportioned to Standard Flats and Carrier Route.[5] We believe they are inordinately high and do not show effects of substantial investments in flat sorting technology in recent years. But it is the rates that must be below stand-alone costs, and we believe they are clearly at or above them.

We are hopeful that operations will tighten around flats much as they appear to have for letters.[6] It is unfair for catalog mailers to be locked into rates that are higher than competition in a delivery market would offer.

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5 *See* Docket No. ACR2014, Initial Comments of ACMA (February 2, 2015).

6 As shown by the ACMA cost index, the cost of letters has increased 18.9 percent since 1998, while factor prices have increased 61.3 percent. On its face, that is a notable accomplishment.

### IV. Conclusion.

For the reasons described in these comments, no special steps should be taken to increase the levels of SF rates. Additional time for the settling in of a large scale automation deployment is required and nothing should be undertaken that threatens to disrupt flats volumes prior to resolving fully both the flats automation system and resolving the outstanding questions on costs. To the extent any realignment is needed, it should focus on FSS rates that bear a reasonable relation to CR rates and to non-CR, non-FSS rates.

While the FSS has promise, it so far has been exacerbating cost coverage and attributions by moving nearly 30 percent of the total flats mailstream from CR, which is very efficient with a healthy cost coverage, to a seriously underperforming and impaired cost category. This needs to be fully understood, because we need to know whether to back up (and how) or to move forward (and how) before there is to be any subsequent rate adjustment. This includes a better understanding of whether the FSS will reach its true potential in the future.

Respectfully submitted,

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